

Internal Revenue Service
memorandum

CC:INTL-0178-91

Br5:CMurphy

JUL 10 1991

date:

to: Chief, Examination Division, New Orleans District, SE:NO
ATTN: Fred Schmitt, Case Manager

from: Chief, CC:INTL:Br5

subject: Computation of branch income under 987

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This responds to your request for technical assistance asking whether section 987 accounts for the amount of the difference in the dollar value of a life insurance branch deduction (relating an increase to a local currency reserve) computed under two alternative methods. Put another way, will the income over the "life" of the branch be the same under each alternative. As illustrated below, the amount of branch income over its life will be the same under each alternative.

Facts

████████████████████ is a domestic corporation with several foreign branches. The income of each branch is computed in local currency (lc) and then translated into dollars. I assume that ██████████ is a calendar year taxpayer.

Using the figures you sent to us, for tax years beginning before ██████████, the total local currency branch income was ██████████ lc. The local currency equity of the branch (assets less liabilities) at the end ██████████ was ██████████ lc. The total dollar amount of branch income through tax year ██████████

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under your column C (method A) was \$ [REDACTED] and was \$ [REDACTED] under your column B (method B). The \$ [REDACTED] difference (\$ [REDACTED] - \$ [REDACTED]) is attributable solely to the method of translating a deduction relating to an increase to a lc reserve. Method A resulted in a total deduction of \$ [REDACTED], while under method B the total deduction was \$ [REDACTED]. This resulted in method B, which the taxpayer used, giving the taxpayer \$ [REDACTED] more in deductions (excess deductions) than it would have obtained under method A. The branch was terminated at the end of [REDACTED] when [REDACTED] lc equalled \$ [REDACTED].

Computation of income over the life of the branch

Method A

\$ income excluding section 987 loss

\$ [REDACTED]

Section 987 loss on termination

\$ value of equity
\$ income before 987 loss
987 loss

\$ [REDACTED]
[REDACTED]
[REDACTED]

Total Dollar Income

\$ income before 987 loss
987 loss
Total \$ income

\$ [REDACTED]
[REDACTED]
\$ [REDACTED]

Method B

\$ income excluding section 987 loss

\$ [REDACTED]

Section 987 loss on termination

\$ value of equity
\$ income before 987 loss
987 loss

\$ [REDACTED]
[REDACTED]
[REDACTED]

Total Dollar Income

\$ income before 987 loss
987 loss
Total \$ income

\$ [REDACTED]
[REDACTED]
\$ [REDACTED]

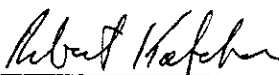
The \$ [REDACTED] section 987 loss under method A is \$ [REDACTED] more than the loss the taxpayer realized utilizing method B. This, in effect, recaptures the excess deductions taken under taxpayer's method B. Thus, use of the section 987

pools recaptures the excess deductions by reducing the section 987 loss on termination. The two methods result in the same total amount of income.

Post-■ years

After ■, the taxpayer is required to use the statutory profit and loss method under section 987. The taxpayer must compute its branch profit and loss at the branch level and translate the result into the taxpayer's functional currency at the average rate for the year. This, of course, would preclude the translation of individual items such as deductions for reserves at other than the average rate. Thus, for example, if there were a 100lc increase in the reserve for a post-■ tax year, that amount would be translated into dollars at the average rate for the year. If there were no lc increase or decrease to the reserve, there would be no deduction or inclusion regardless of the change in the lc/\$ exchange rate.

If you have any questions, please call Bob Katcher at FTS 566-6795.


Robert Katcher
Chief, Branch 5
Office of Associate Chief
Counsel (International)

987 ■ 5